grimesco.com



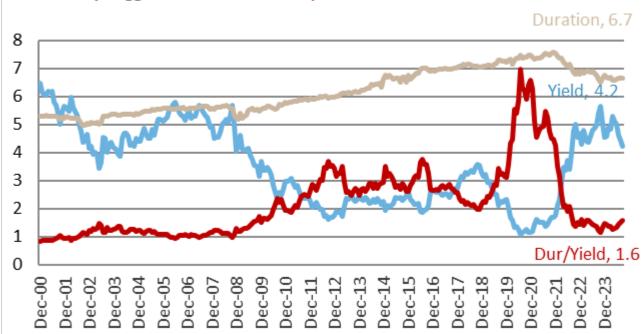


10.17.24 | INVESTMENT MANAGEMENT 2024 Outlook Theme #2: Duration's Boost to Bonds Could Be Short Lived By Benjamin B. Wallace, CFA Benjamin B. Wallace, CFA - Portfolio Manager, Research Director

The prior economic analysis suggests that interest rates are at the low end of the "soft landing" range. What do valuations say about the appeal of bonds at this interest rate level? The link between interest rate changes and bond prices is called duration, measuring the sensitivity of a bond's price to changes in interest rates, with the value representing the percent change in a bond's price for a 1% change in rates. For example, a bond with a duration of five would lose 5% if interest rates rose 1%.

For valuing bonds, one metric we focus on is the ratio of Duration to Yield, which is in Chart 1. Before the Global Financial Crisis in 2009, this ratio was in a range of 1.0 to 1.4. During the two recent highs for interest rates (October 2023 and April 2024), the yield on the Bloomberg Barclays Aggregate (Agg) exceeded 5%, and the Duration/Yield rate finally returned to that range, reaching 1.4 on 6/30/24. This set up a Q3'24 5% Agg return, as rates declined, boosting prices. With the yield on the Agg back down to 4.2%, the ratio is back up to 1.6. To get back to 1.4 would require a modest rise to 4.8%. With a duration of 6.7, that 0.6% rate rise could cause a 4% price decline, reversing most, but not all, of the Agg's 5% Q3'24 return that accrued due to falling rates during the period.





## Barclays Agg Index Yield, Duration/Yield and Duration

## Chart 1

This analysis offers insight into other parts of the bond market. Chart 2 shows the same Duration/Yield calculation for the Agg, as well as for the BofA Investment Grade (Igrade) and the BofA High Yield (HiYield) indices. Similar to the Agg, both the Igrade and HiYield ratios reached (unappealing) highs in late 2021 but have since returned to levels comparable to their pre-GFC ratios. Table 1 compares their current ratios to their averages from 2003 to 2007, as a baseline for a "normalized" interest rate environment. The Agg's significant weighting in government securities keeps its yield lower and duration higher, while escalating credit exposure increases the yield relative to duration for Igrade and HiYield.



grimesco.com

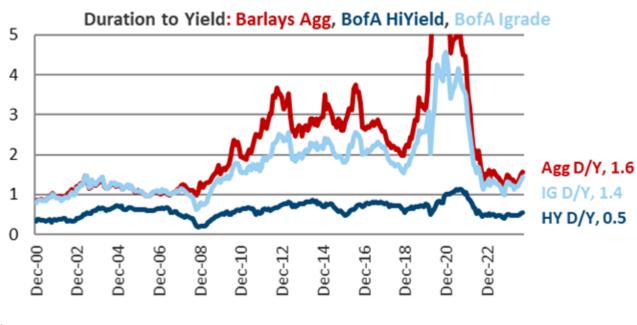


Chart 2

Duration/Yield	Agg	Igrade	HiYield
9/30/2024	1.6	1.4	0.5
2003-2007 Average	1.1	1.2	0.6

## Table 1

The better ratios for Igrade and HiYield illustrate why these two segments of the bond market have done well in the "soft landing" market thus far. They have less exposure to interest rate movement, but as long as the economy avoids a recession, they can deliver higher yields.

After falling rates boosted bond prices in Q3'24, some caution is warranted for Fixed Income, as the macro-economic factors suggest an upward bias to rates, and the Duration/Yield benefit suggests valuations are slightly extended. On the plus side, they still offer the benefit of diversification should a recession or other risk cause interest rates to fall further. Should the current soft-landing scenario continue, HiYield and Igrade can benefit as well, as they offer higher yields and lower duration than the Agg. The longer term outlook is reasonable, though *Duration's Boost to Bonds Could be Short Lived*.

## IMPORTANT DISCLOSURES:

Please remember that past performance is no guarantee of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Grimes & Company, Inc. ["Grimes]), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or



information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from Grimes. No amount of prior experience or success should not be construed that a certain level of results or satisfaction if Grimes is engaged, or continues to be engaged, to provide investment advisory services. Grimes is neither a law firm, nor a certified public accounting firm, and no portion of the commentary content should be construed as legal or accounting advice. A copy of the Grimes' current written disclosure Brochure discussing our advisory services and fees continues to remain available upon request or at www.grimesco.com. **Please Remember**: If you are a Grimes client, please contact Grimes, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. Unless, and until, you notify us, in writing, to the contrary, we shall continue to provide services as we do currently. **Please Also Remember to advise us** if you have not been receiving account statements (at least quarterly) from the account custodian. Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Grimes account holdings correspond directly to any comparative indices or categories. **Please Also Note**: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Grimes accounts; and, (3) a description of each comparative be

The information contained herein is based upon sources believed to be true and accurate. Sources include: *Factset Research Systems Inc.*, Bureau of Economic Analysis, Bureau of Labor Statistics, Congressional Budget Office, Board of Governors of Federal Reserve System, Fred: Federal Reserve Bank of St. Louis Economic Research, U.S. Department of the Treasury

-The Standard & Poor's 500 is a market capitalization weighted index of 500 widely held domestic stocks often used as a proxy for the U.S. stock market. The Standard & Poor's 400 is a market capitalization weighted index of 400 mid cap domestic stocks. The Standard & Poor's 600 is a market capitalization weighted index of 600 small cap domestic stocks.

-The NASDAQ Composite Index measures the performance of all issues listed in the NASDAQ stock market, except for rights, warrants, units, and convertible debentures.

-The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of 21 emerging markets. The MSCI All Country World Index is a free float adjusted market capitalization index designed to measure the performance of large and mid and cap stocks in 23 developed markets and 24 emerging markets. With over 2,800 constituents it represents over 85% of the global equity market.

-The Barlcays Aggregate Index represents the total return performance (price change and income) of the US bond market, including Government, Agency, Mortgage and Corporate debt.

-The BofA Merrill Lynch Investment Grade and High Yield Indices are compiled by Bank of America / Merrill Lynch from the TRACE bond pricing service and intended to represent the total return performance (price change and income) of investment grade and high yield bonds.

-The S&P/LSTA U.S. Leveraged Loan 100 is designed to reflect the largest facilities in the leveraged loan market. It mirrors the market-weighted performance of the largest institutional leveraged loans based upon market weightings, spreads and interest payments.

-The S&P Municipal Bond Index is a broad, comprehensive, market value-weighted index. The S&P Municipal Bond Index constituents undergo a monthly review and rebalancing, in order to ensure that the Index remains current, while avoiding excessive turnover. The Index is rules based, although the Index Committee reserves the right to exercise discretion, when necessary.

-The BofA Merrill Lynch US Emerging Markets External Sovereign Index tracks the performance of US dollar emerging markets sovereign debt publicly issued in the US and eurobond markets.

-The HFRI Fund of Funds index is compiled by the Hedge Funds Research Institute and is intended to represent the total return performance of the entire hedge fund universe.